CONTENTS

Chapter 1 An Overview of Financial Markets and Institutions 1
  Chapter Preview 2
  Learning Objectives 2
  1.1 The Financial System 2
  1.2 Financial Markets and Direct Financing 5
  1.3 Types of Financial Markets 8
  PEOPLE & EVENTS: Wall Street Faces Global Competition 9
  1.4 The Money Markets 12
  1.5 The Capital Markets 13
  1.6 Financial Intermediaries and Indirect Financing 15
  1.7 Types of Financial Intermediaries 21
  1.8 The Risks Financial Institutions Manage 27
  1.9 Regulation of the Financial System 29
  Summary of Learning Objectives 32
  Key Terms 34
  Questions and Problems 34

Chapter 2 The Federal Reserve and Its Powers 35
  Chapter Preview 36
  Learning Objectives 36
  2.1 Origins of the Federal Reserve System 36
  2.2 The Current Structure of the Fed 41
  2.3 Monetary Powers of the Board of Governors 44
  2.4 The Fed’s Regulatory Powers 45
  2.5 Independence of the Fed 49
  2.6 The Fed’s Balance Sheet 51
  Learning by Doing 2.1: Computing a Bank’s Excess Reserve Position 57
  2.7 The Fed’s Role in Check Clearing 57
  2.8 Federal Reserve Tools of Monetary Policy 58
  PEOPLE & EVENTS: A Contrast in Style: Greenspan Versus Bernanke 59
  Learning by Doing 2.2: Calculating a Bank’s Reserve Position 64
  Summary of Learning Objectives 67
  Key Terms 68
  Questions and Problems 68
Chapter 3  The Fed and Interest Rates  70
Chapter Preview  71
Learning Objectives  71
3.1 Federal Reserve Control of the Money Supply  71
3.2 The Fed's Influence on Interest Rates  74
3.3 The Treasury Department and Fiscal Policy  79
3.4 Goals of Monetary Policy  82
PEOPLE & EVENTS: The Fed as Lender of Last Resort: Preventing a Financial Panic  88
3.5 The Fed and the Economy  90
3.6 Complications of Monetary Policy  93
3.7 Anatomy of a Financial Crisis  94
Summary of Learning Objectives  102
Key Terms  103
Questions and Problems  103

Chapter 4  The Level of Interest Rates  105
Chapter Preview  106
Learning Objectives  106
4.1 What Are Interest Rates?  106
4.2 The Real Rate of Interest  107
4.3 Loanable Funds Theory of Interest  110
4.4 Price Expectations and Interest Rates  113
PEOPLE & EVENTS: Can Interest Rates be Negative?  121
4.5 Forecasting Interest Rates  121
Summary of Learning Objectives  123
Key Terms  124
Questions and Problems  124

Chapter 5  Bond Prices and Interest Rate Risk  125
Chapter Preview  126
Learning Objectives  126
5.1 The Time Value of Money  126
5.2 Bond Pricing  128
PEOPLE & EVENTS: Rogue Trader Incurs Huge Financial Losses for French Bank  130
Learning by Doing 5.1: Calculating the Price of a Bond Using a Financial Calculator  133
5.3 Bond Yields  134
Learning by Doing 5.2: Calculating the Yield-to-Maturity on a Bond  135
5.4 Important Bond Pricing Relationships  139
5.5 Interest Rate Risk and Duration  143
Learning by Doing 5.3: Calculating the Duration of a Bond  144
Summary of Learning Objectives  153
Key Terms  154
Questions and Problems  154
Chapter 6 The Structure of Interest Rates 156
  Chapter Preview 157
  Learning Objectives 157
  6.1 The Term Structure of Interest Rates 157
  Learning by Doing 6.1: Using the Term Structure Formula to Calculate Implied Forward Rates 163
  6.2 Default Risk 169
  PEOPLE & EVENTS: The Credit-Rating Club 174
  6.3 Tax Treatment 175
  6.4 Marketability 177
  6.5 Options of Debt Securities 178
  6.6 Behavior of Interest Rates over the Business Cycle 180
  Summary of Learning Objectives 182
  Key Terms 183
  Questions and Problems 184

Chapter 7 Money Markets 186
  Chapter Preview 187
  Learning Objectives 187
  7.1 How the Money Markets Work 187
  7.2 Economic Role of the Money Markets 188
  7.3 Features of Money Market Instruments 189
  7.4 Treasury Bills 190
  Learning by Doing 7.1: Calculating the Discount Yield 194
  Learning by Doing 7.2: Calculating the Bond Equivalent Yield 195
  7.5 Federal Agency Securities 196
  7.6 Fed Funds 199
  7.7 Other Major Money Market Instruments 201
  PEOPLE & EVENTS: Lehman Brothers’ “Creative” Accounting: Repos 105 and 108 204
  7.8 Money Market Participants 211
  7.9 The Impact of the 2007–2009 Financial Crisis on the Money Markets 214
  Summary of Learning Objectives 219
  Key Terms 220
  Questions and Problems 220

Chapter 8 Bond Markets 221
  Chapter Preview 222
  Learning Objectives 222
  8.1 Functions of the Capital Markets 222
  8.2 U.S. Government and Agency Securities 224
  PEOPLE & EVENTS: What Do Negative Yields on TIPS Tell Us? 228
  8.3 State and Local Government Bonds 230
  8.4 Corporate Bonds 235
  8.5 Financial Guarantees 240
Chapter 14 International Banking 416
Chapter Preview 417
Learning Objectives 417
14.1 Development of International Banking 417
14.2 Regulation of Overseas Banking Activities 420
PEOPLE & EVENTS: Credit Risk, Subprime Mortgage Crisis of 2007, and Challenges to the Banking Sector 424
14.3 Delivery of Overseas Banking Services 424
14.4 International Lending 429
14.5 Foreign Banks in the United States 436
14.6 Future Directions of International Banking 440
Summary of Learning Objectives 441
Key Terms 441
Questions and Problems 441

Chapter 15 Regulation of Financial Institutions 443
Chapter Preview 444
Learning Objectives 444
15.1 Reasons for Regulation 444
15.2 Bank Failures and Regulation 448
PEOPLE & EVENTS: WaMu and the Destructive “Power of Yes” 453
15.3 Safety and Soundness Regulation: Deposit Insurance 454
15.4 Deposit Insurance Issues 456
15.5 Safety and Soundness Regulation: Capital Requirements 460
15.6 Bank Examinations 465
15.7 Structure and Competition Regulations 467
15.8 Consumer Protection Regulations 470
15.9 Bank Regulators 473
Summary of Learning Objectives 476
Key Terms 476
Questions and Problems 477
Chapter 16 Thrift Institutions and Finance Companies 478

Chapter Preview 479
Learning Objectives 480
16.1 Historical Development of Savings Institutions 480
16.2 Operations of Savings Institutions 484
16.3 Credit Unions 492
PEOPLE & EVENTS: Demographic Change Brings Opportunity 493
PEOPLE & EVENTS: Commercial Banks Versus Credit Unions 498
16.4 Thrift Institutions Around the Globe 499
16.5 Finance Companies 500
Summary of Learning Objectives 508
Key Terms 509
Questions and Problems 509

Chapter 17 Insurance Companies and Pension Funds 510

Chapter Preview 511
Learning Objectives 511
17.1 Insurance 511
17.2 The Insurance Industry 515
PEOPLE & EVENTS: The Rise, Fall, and Return of American International Group (AIG) 518
17.3 Life and Health Insurance 523
Learning by Doing 17.1: Calculating Policyholders' Surplus 529
17.4 Property and Liability Insurance 529
Learning by Doing 17.2: Measuring Insurance Company Profitability with the Combined Ratio 532
17.5 Pensions 532
Summary of Learning Objectives 538
Key Terms 539
Questions and Problems 539

Chapter 18 Investment Banking 541

Chapter Preview 542
Learning Objectives 542
18.1 The Relationship Between Commercial and Investment Banking 542
PEOPLE & EVENTS: Where, Oh, Where Have All the Investment Banks Gone? 548
18.2 Primary Services of an Investment Bank 549
18.3 Private Equity 559
Learning by Doing 18.1: Evaluating a Venture Capital Investment 562
Summary of Learning Objectives 565
Key Terms 565
Questions and Problems 566

Chapter 19 Investment Companies 567

Chapter Preview 568
Learning Objectives 568
19.1 Investment Companies 568
Contents

19.2 Open-End Mutual Funds  569
Learning by Doing 19.1: Calculating Net Asset Value  570
19.3 Closed-End Mutual Funds  581
19.4 Exchange-Traded Funds  584
19.5 Hedge Funds  587
PEOPLE & EVENTS: Hedge Funds and the Dodd-Frank Wall Street Reform and Consumer Protection Act  588
19.6 Real Estate Investment Trusts  591
Summary of Learning Objectives  595
Key Terms  595
Questions and Problems  595

Chapter 20 Risk Management in Financial Institutions  597

Chapter Preview  598
Learning Objectives  598
20.1 The Dilemma: Profitability Versus Safety  598
20.2 Liquidity Management  600
PEOPLE & EVENTS: Operational Risk  604
20.3 Managing Credit Risk  604
PEOPLE & EVENTS: Counterparty Controversy: AIG and Its Risky Risk Management  608
20.4 Measuring and Assessing Interest Rate Risk  609
20.5 Hedging Interest Rate Risk  617
Learning by Doing 20.1: Measuring Interest Rate Risk  623
Summary of Learning Objectives  626
Key Terms  626
Questions and Problems  627

Glossary  628

Index  651